

the organization for services rendered. If the nursing facility's legal obligation to pay the organization of nonpaid workers is nullified by an offsetting legal obligation by the organization of nonpaid workers to pay or make a contribution to the nursing facility of all or part of the salary liability, the amount paid or contributed by the organization of nonpaid workers is not an allowable cost.

(iii) A payment made by the organization of nonpaid workers to the nursing facility for the nonpaid workers' maintenance, perquisites or fringe benefits shall be used as an offset to the total of the cost actually incurred by the nursing facility.

(iv) Staff services relating to the use of volunteer workers are allowable costs.

(4) *Pastoral services.*

(i) Salary costs for pastoral services rendered directly to residents by professional staff employed by, or under contract with, the nursing facility are allowable costs.

(ii) Costs for a chaplaincy training program and pastoral housing are not allowable costs.

§1187.56. Selected administrative cost policies.

Policies for selected administrative costs are as follows:

(1) *Administrative allowance.*

(i) The allowable administrative costs incurred by a nursing facility to provide services are subject to the following limitation: the allowable administrative costs will be determined so that all other allowable costs, excluding capital costs, equal no less than 88% of the allowable net operating costs.

(ii) Home office cost allocations and management fees are subject to the following conditions and limitations:

- (A) Home office cost allocations and management fees between related parties shall be reported without markup by the nursing facility.
- (B) Costs which are not allowable, such as those related to nonworking officers or officers' life insurance, may not be included in home office allocations or management fees.
- (C) Documentation relating to home office and management costs shall be provided to the Department's auditors upon request.
- (D) Home office allocations, including administratively allowable depreciation and interest costs relating to transportation equipment, shall be reported in the general administration line on the cost report.

(iii) A nursing facility providing nursing, residential and other services shall allocate the total administrative cost to nursing, residential and other services on the basis of a percentage of these costs to the total net operating costs.

(2) *Administrative cost interest allowance.*

- (i) Interest on indebtedness related to short-term financing or raising of capital for operational expenses and obligations is an allowable administrative interest cost expense. To be considered allowable, necessary and proper, the interest expense shall be incurred and paid within 90 days of the close of the cost reporting period on a loan made to satisfy a financial need of the nursing facility and for a purpose related to resident care. Interest expense on indebtedness incurred to pay interest is nonallowable.
- (ii) Necessary and proper interest on indebtedness related to the procurement of transportation equipment, including equipment for normal, standby or emergency use, is an allowable administrative interest cost expense, if the nursing facility is the recorded holder of legal title to the transportation equipment and the transportation equipment is used to provide compensable services to MA residents.
- (iii) The total amount of loans related to allowable transportation equipment may not exceed the depreciation basis of the asset.

(iv) Allowable interest on indebtedness shall not exceed that amount which a prudent borrower would pay as described in the Medicare Provider Reimbursement Manual (HCFA Pub. 15-1).

(v) Interest expense is allowable if paid on loans from the nursing facility's donor-restricted funds, the funded depreciation account or the nursing facility's qualified pension fund.

(vi) Monies borrowed for the purchase or redemption of capital stock will be considered a loan for investment purposes. The interest paid on these borrowed funds is a nonallowable cost. The use of funds by the nursing facility for the redemption of capital stock will be considered as an investment of available funds.

(vii) Interest expense on funds borrowed for transportation equipment purchases will not be allowed until the funds in the nursing facility's funded depreciation account are fully expended.

(3) *Investment Income.*

(i) Investment income is used to reduce allowable administrative interest expense unless the investment income is from one of the following:

(A) Gifts or grants of which the corpus and interest are restricted by the donor.

(B) Funded depreciation maintained in accordance with Federal regulations.

(C) The nursing facility's qualified pension fund, if the interest earned remains in the fund.

(D) Issuer specified designated capital bond funds or debt service reserve funds.

(ii) Investment income on funds found to be used for purposes other than their designated purpose or commingled with other funds will be used to reduce allowable administrative interest expense.

(4) *Administrative cost transportation equipment depreciation.*

(i) Depreciation on transportation equipment, including equipment for normal, standby or emergency use, is an allowable administrative cost, if the nursing facility is the recorded holder of legal title to the transportation equipment and the transportation equipment is used to provide compensable services to MA residents.

(ii) The straight-line method of depreciation shall be used. Accelerated methods of depreciation are not acceptable. The amount of annual depreciation shall be determined by first reducing the cost of the asset by salvage value and dividing by the number of years of useful life of the asset. A useful life may not be less than the relevant useful life published by the American Hospital Association (AHA) or the Internal Revenue Service for the particular asset on which the depreciation is claimed.

(iii) Depreciation expense for the year of acquisition and the year of disposal shall be computed by using either the half-year or actual time method of accounting, provided that the number of months of depreciation expense exceeds the number of months that the asset was in service.

(iv) The method and procedure, including the assigned useful lives, for computing depreciation shall be applied from year to year on a consistent basis from the date of the nursing facility's first filed cost report and may not be changed.

(v) Transportation equipment shall be recorded at cost. Donated assets shall be recorded at the current appraisal value. When an asset is acquired by a trade-in, the cost of the new asset shall be the sum of the book value of the old asset and any cash or issuance of debt as consideration paid.

(vi) Gains on the sale of transportation equipment shall offset the nursing facility's total transportation depreciation expense in the 365 days preceding the date that the asset was sold or retired from service. Losses incurred on the sale or disposal of transportation equipment are not allowable costs.

(5) General administration expenses.

(i) Salaries of the nursing facility's administrator, comptroller, purchasing agent, personnel director, pharmacy consultant and

other persons performing general supervision or management duties are allowable as general administrative costs.

(ii) The salary or compensation costs of owners, operators or persons other than nursing facility employees shall be included as allowable costs only to the extent of their documented time and involvement in the required management of a nursing facility. These costs mean actual payment made during the cost reporting period on a current basis of salary or benefits for services rendered to the nursing facility.

(iii) If a person performs work customarily performed by different or several types of employees, the cost of the salary and other compensation allowable for the person shall be determined by the prorated customary salary and other compensation paid to employees for performing the same types of work. This cost is allowable only if adequate documentation verifying the cost is supplied by the nursing facility.

(iv) The allowable cost for a person performing necessary duties may not exceed the customary compensation and fringe benefits that an employee would normally receive while performing that work.

(6) *Contracted management services.*

(i) In lieu of home office allocations or management fees, a nursing facility may contract with a nonrelated management service. The cost of this contract shall be shown as an administrative cost and may not be allocated among other cost centers.

(ii) Management services contracted with a related party shall be treated as home office allocations.

(7) Rental expense for plant, property and equipment. Rental expense for plant, property and equipment is not recognized as a separate allowable cost. It is included in the fair rental value.

§1187.57. Selected capital cost policies.

(a) Payment of capital costs will be determined on a facility-specific, prospective basis and will be based upon the fair rental value of the nursing facility, the financial

yield rate and the nursing facility's real estate taxes or reasonable payment made in lieu of real estate taxes.

(b) A nursing facility will be appraised at its depreciated replacement cost by qualified personnel from an independent appraisal firm under contract with the Department.

(1) The depreciated replacement cost of each nursing facility as of March 31, 1995, will be used for the January 1, 1996, rate setting. Capital rates will be established annually.

(2) Nursing facilities will be reappraised at least every 5 years after implementation of the case-mix payment system.

(3) Limited appraisals will be conducted when a nursing facility makes additions or deletions to capital of more than \$200,000 or 10% of the appraised value, whichever is lower.

(4) The Department will participate in reimbursing a maximum cost per bed regardless of the appraisal value under §1187.112 (relating to cost per bed limitation adjustment).

(5) The original cost of a nursing facility will not be a factor in the determination of the appraised depreciated replacement cost.

(c) When there is a change in nursing facility ownership, the new nursing facility owner will maintain the same appraisal value as the former owner.

(d) The Department will recognize capital costs for new or additional beds subject to the conditions in §1187.113 (relating to capital component payment limitation).

§1187.58. Costs of related parties.

Costs applicable to services and supplies furnished to the nursing facility by organizations related to the nursing facility by common ownership or control shall be included as an allowable cost of the nursing facility at the cost to the related organization. This cost may not exceed the price of comparable services or supplies that could be purchased elsewhere.

§1187.59. Nonallowable costs.

(a) *Nonallowable costs related to expenses and revenues.* The Department will not recognize as allowable costs the expenses or revenues of a nursing facility related to:

- (1) Nonworking officers' or owners' salaries.
- (2) Fundraising expenses for capital and replacement items exceeding 5% of the amount raised and, for operating expenses and cash flow, fundraising expenses exceeding 10% of the amount raised.
- (3) Free care or discounted services.
- (4) Parties and social activities not related to resident care.
- (5) Organizational memberships not necessary to resident care.
- (6) Personal telephone service.
- (7) Personal television service.
- (8) The direct and indirect costs related to nonallowable cost centers, including gift, flower and coffee shops, homes for administrators or pastors, convent areas and nurses' quarters, except as provided in §1187.55(3) (relating to selected resident care and other resident related cost policies).
- (9) Vending machines.
- (10) Charitable contributions.
- (11) Employee and guest meals.
- (12) Pennsylvania Capital Stock and Franchise Tax.
- (13) Income Tax.
- (14) Ambulance costs.
- (15) Promotional advertising, including a yellow page listing larger than a minimum insert.

- (16) Late payment penalties.
- (17) Taxes based upon net income.
- (18) Officers' and directors' life insurance, including life insurance premiums necessary to obtain mortgages and other loans.
- (19) Bad debts or contractual adjustments.
- (20) Collection expenses associated with bad debts.
- (21) Losses on the sale of fixed and movable assets.
- (22) Remuneration of any kind for any purpose, including travel expenses for members of the Board of Directors.
- (23) Dry cleaning, mending or other specialty laundry services.
- (24) Depreciation and interest on indebtedness for capital plant facilities not included in the fair rental value payment.
- (25) Expenses or revenues not necessary to resident care.
- (26) Costs, including legal fees, accounting and administrative costs, travel costs and the costs of feasibility studies, attributable to the negotiation or settlement of the sale or purchase of a capital asset - by acquisition or merger - for which payment has previously been made under Title XVIII of the Social Security Act (42 U.S.C.A. §§1395 - 1395yy) if the sale or purchase was made on or after July 18, 1984.
- (27) Letter of credit costs.
- (28) Legal expenses related to an appeal or action challenging a payment determination under this chapter unless and until a final adjudication is issued sustaining the nursing facility's appeal. If the nursing facility prevails on some but not all issues raised in the appeal or action, a percentage of the reasonable legal expenses is allowable based upon the proportion of additional reimbursement received to the total additional reimbursement sought on appeal.
- (29) Nonstandard or nonuniform fringe benefits.
- (30) Return on net equity and net worth.

(b) *Nonallowable costs related to revenue producing items.* In determining the operating costs of a nursing facility, the Department will not allow costs related to:

- (1) The sale of laundry and linen service.
- (2) The sale of drugs to nonresidents.
- (3) The sale of medical and surgical supplies to nonresidents.
- (4) The sale of clinical records and abstracts.
- (5) The rental of quarters to employees and others.
- (6) The rental of space within the nursing facility.
- (7) The payments received from clinical specialists.
- (8) Discounts on purchases which include trade, quantity and time.
- (9) Rebates and refunds of expenses.

(c) *Income that reduces allowable costs.*

- (1) Except as provided in §1187.56(3)(i) (relating to selected administrative cost policies), any form of investment income shall be used to reduce the allowable administrative interest expense.
- (2) Grants, gifts and income designated by the donor for specific operating expenses are used to reduce the allowable costs relating to the specific operating expense.
- (3) Recovery of insured loss shall be used to reduce the allowable costs relating to the insured loss.
- (4) Applicable revenue producing items, other than room and board, shall be used to reduce the related allowable costs.

(d) *Nonallowable direct nursing facility payments.* Costs for prescription drugs, physician services, dental services, dentures, podiatry services, eyeglasses, appliances, x-rays, laboratory services and other materials or services covered by payments, other than MA or Medicare Part A, made directly to nursing facilities, including Medicare Part B, Champus, Blue Cross, Blue Shield or other insurers or third parties, are not allowable in determining net operating costs.

§1187.60. Prudent buyer concept.

The purchase or rental by a nursing facility of equipment, services, supplies, including pharmaceuticals, and the like, may not exceed the cost that a prudent buyer would pay in the open market to obtain these items, as described in Medicare Provider Reimbursement Manual (HCFA Pub. 15-1).